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No. 95-450

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

ORIX CREDIT ALLIANCE, INC.,

Petitioner,

v.

DELTA RESOURCES, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

MOTION OF AMERICAN COUNCIL OF LIFE INSURANCE FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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MOTION OF AMERICAN COUNCIL OF LIFE INSURANCE FOR LEAVE TO FILE BRIEF AMICUS CURIAE

American Council of Life Insurance ("ACLI") respectfully moves for leave to file the attached brief *amicus curiae* in this case. The consent of the attorney for the petitioner has been obtained and is attached. The consent of the attorney for the respondent was requested but refused.

ACLI is the principal national trade association of the life insurance industry. ACLI's 606 member companies account for 91% of the legal reserve life insurance in this country and are among the nation's largest and most significant commercial lenders. In 1993, life insurance companies' net investment in U.S. capital markets totaled $143.7 billion — ranking third (only after mutual funds and commercial banks) among private domestic capital sources.[1]

The interest of the ACLI as *amicus* arises out of the importance of the decision below to the commercial lending community. That decision categorically holds that bankruptcy courts are precluded, as a matter of law, from ordering payment of postpetition interest as part of the "adequate protection" of an oversecured creditor's "interest in property."

Interest payments, however, are a basic form of adequate protection accorded oversecured creditors in bankruptcy, and often are provided by stipulations allowing bankruptcy debtors to use cash collateral. The national impact and consequences of the decision below, which would bar such payments as a matter of law, are potentially profound.

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[1] American Council of Life Insurance, *1994 Life Insurance Fact Book* 83-107 (1994).

As a principal source of investment capital in the United States, life insurance companies have a broad and important view on the reasons why Supreme Court review is needed here. ACLI's perspective as to the actual, practical effect of the decision below is necessarily more far reaching than that of Petitioner Orix Credit Alliance, Inc., whose petition ACLI supports.

Respectfully submitted,

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October 12, 1995

BRIEF OF AMICUS CURIAE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

This brief, in support of the Petition for a Writ of Certiorari, is submitted in accordance with Rule 37 of the Rules of this Court and pursuant to the foregoing motion for leave to file.

INTEREST OF AMICUS CURIAE

The motion of American Council of Life Insurance ("ACLI") for leave to file this brief sets forth ACLI's interest as amicus curiae.

REASONS FOR GRANTING PETITION

THE COURT OF APPEALS HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THE COURT. SPECIFICALLY, (A) THE DECISION BELOW THREATENS TO UPSET ACCEPTED PRACTICES AS TO CONTINUING PAYMENT OF INTEREST ON OVERSECURED CLAIMS DURING BANKRUPTCY; (B) THE DECISION BELOW IS BASED ON A MISUNDERSTANDING OF THE COURT'S DECISION IN *UNITED SAV. ASS'N V. TIMBERS OF INWOOD FOREST ASSOCS., LTD.*, 484 U.S. 365 (1988), WHICH DEALS WITH ADEQUATE PROTECTION AND PAYMENT OF INTEREST TO UNDERSECURED CREDITORS; AND (C) THE AUTHORITATIVE VOICE OF THE COURT IS NEEDED TO CLARIFY THE MEANING OF *TIMBERS* AND ITS DICTA IN THE CONTEXT OF OVERSECURED DEBT.

I. The Authoritative Voice Of The Court Is Needed To Clarify The Meaning Of Timbers And Its Dicta In The Context of Oversecured Debt.

Discussion of the oversecured creditor's rights to payment of interest accruing postpetition necessarily focuses on *United Sav. Ass'n. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988). *Timbers* held that an undersecured creditor is not entitled to payment of postpetition interest to assure adequate protection of its property interest under § 362(d)(1) of the Bankruptcy Reform Act of 1978 ("Bankruptcy Code"), 11 U.S.C. §§ 101-1330 (1994). 484 U.S. at 382. However, in far-ranging dicta, the Court also discussed interest on oversecured claims and the concepts and Bankruptcy Code provisions applicable to such claims. *Id.* at 373-74.

Judicial responses to *Timbers'* teaching as to oversecured claims have differed. On the basis of *Timbers*, the decision below holds that an oversecured creditor "as a matter of law, was not entitled to receive periodic payments for accruing postpetition interest as part of adequate protection for any period of time." *In re Delta Resources, Inc.*, 54 F.3d 722, 730 (11th Cir. 1995) (footnote omitted); App. 17.[2] The court of appeals emphasized:

> The *ratio decidendi* enunciated by the Supreme Court in *Timbers* that an undersecured creditor is not entitled to receive postpetition interest on its collateral *during the stay* to assure adequate protection under 11 U.S.C. § 362(d)(1) applies equally well to an oversecured creditor.

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[2] "App." refers to the Appendix to the Petition.

54 F.3d at 730; App. 16. The holding of the court of appeals is not only erroneous but also symptomatic of the pressing need for clarification of *Timbers*.

A. Under Timbers The Right Of A Secured Creditor To Have The Equity Cushion Applied To Payment Of Its Claim, Including Postpetition Interest, Is Entitled To Adequate Protection.

A claim is oversecured when the value of the collateral that secures it is greater than the amount of the claim. Under § 506(b) of the Bankruptcy Code, an oversecured creditor is entitled to postpetition interest as part of its claim. Postpetition interest, however, may "be paid only out of the 'security [equity] cushion,' " i.e., the value of the collateral that exceeds the secured debt. *Timbers*, 484 U.S. at 372. Under *Timbers*, moreover, the equity cushion serves as a limit on the total amount of interest allowable. *Id.*

An oversecured creditor's claim grows postpetition to reflect accruing interest and other charges allowable under Section 506(b). *Rake v. Wade*, ___ U.S. ___, 113 S. Ct. 2187, 2191 (1993) ("[S]uch interest accrues as part of the allowed claim from the petition date until the confirmation or effective date of the plan."). Under the reasoning of *Timbers*, accruing interest is charged against the equity cushion until the cushion is fully consumed. *See* 484 U.S. at 372.

As made clear in *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992), the cushion itself can be created or increased during the course of a bankruptcy case, thereby increasing the amount of a

secured claim.[3] Likewise, the equity cushion can be decreased or eliminated postpetition — by, inter alia, grant of a priming lien (i.e., a lien senior or equal in priority to existing encumbrances) under § 364(d) of the Bankruptcy Code; expenditure of the collateral, if it consists of rents or other cash items; or depreciation. Absent "adequate protection" under the Bankruptcy Code,[4] such invasion of the cushion could eliminate the oversecured creditor's right to postpetition interest.

Since the source of the payment of postpetition interest is the equity cushion, oversecured lenders typically seek to protect the cushion. *Timbers* expressly recognizes that oversecured creditors "*have* a perfected security interest" in the equity cushion. 484 U.S. at 374 (emphasis in original). *Timbers* also states that "the 'interest in property' referred to by § 362(d)(1)

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[3] *Dewsnup* holds that a debtor cannot limit an allowed secured claim to the value of the collateral on the petition date. Rather, "[a]ny increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed and who have nothing to do with the mortgagor-mortgagee bargain." 502 U.S. at 417.

Although *Dewsnup* was a chapter 7 case, its analysis should govern in chapter 11 as well. *In re Bloomingdale Partners*, 160 B.R. 93, 97 (Bankr. N.D. Ill. 1993). Under 11 U.S.C. § 1129(a)(7)(A)(ii), commonly referred to as the "best interest test," a creditor must recover, under a chapter 11 plan, property worth at least as much as that which would be received in a chapter 7 liquidation. *Bloomingdale*, 160 B.R. at 97.

[4] Adequate protection of a secured creditor's "interest in property" is required whenever the creditor's right to realize the value of its collateral is impaired. See Bankruptcy Code § 362(d) (automatic stay against foreclosure will be lifted if secured creditor lacks adequate protection); Bankruptcy Code § 363(e) (debtor cannot use, sell or lease collateral without adequate protection to lien holder); and Bankruptcy Code § 364(d) (debtor cannot grant priming liens to postpetition lender unless it provides adequate protection to existing lien holder).

[i.e., the interest entitled to adequate protection] includes the right of a secured creditor to have the security applied in payment of the debt upon completion of the reorganization." *Id.* at 370. To secure that right, the cushion must be preserved, at least to the extent of anticipated interest and charges.

Both before *Timbers* and after, courts have allowed adequate protection payments of interest, thereby ensuring that oversecured creditors ultimately realize the full amount of their claims.[5] Such protection of the right to have the cushion applied to payment of accruing postpetition interest comports with the legislative history of the Bankruptcy Code, which emphasizes that "adequate

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[5] *E.g.*, *In re Revco D.S., Inc.*, 901 F.2d 1359, 1364-65 (6th Cir. 1990) (granting oversecured creditors interest payments during bankruptcy to protect rights in face of postpetition priming lien); *In re Veeco Inv. Co., L.P.*, 170 B.R. 149, 153 (Bankr. E.D. Mo. 1994) (allowing oversecured creditor to apply adequate protection payments to accrued postpetition interest); *In re Dilts*, 143 B.R. 644, 648 (Bankr. W.D. Pa. 1992) (allowing oversecured creditor to apply adequate protection payments to accrued postpetition interest); *In re McKillips*, 81 B.R. 454, 458 (Bankr. N.D. Ill. 1987) ("The Debtors should pay accruing interest to maintain the cushion."); *In re Mr. D Realty Co.*, 27 B.R. 359, 365-66 (Bankr. S.D. Ohio 1983) (suggesting to debtor that it pay interest as adequate protection to avoid erosion of equity cushion); *In re 5-Leaf Clover Corp.*, 6 B.R. 463, 467 (Bankr. S.D. W. Va. 1980) (holding debtor must at least make adequate protection payments equal to combined depreciation and interest on oversecured debt); *see also In re Pitts*, 2 B.R. 476, 478, 479 (Bankr. C.D. Cal. 1979) ("The existence of an equity, in terms of collateral value in excess of the secured creditor's claim, is an elementary and fundamental part of the transaction" between the creditor and the debtor, entitled to "the structuring of relief calculated to avoid dissipation of whatever protection the cushion affords."). *Compare In re James Wilson Assocs.*, 965 F.2d 160, 171 (7th Cir. 1992) (allowing debtor to use cash collateral where real estate collateral alone worth almost twice as much as unpaid balance of first lienor's mortgage because "[t]he first lienor is entitled to the preservation of so much of his security interest as is necessary generously to secure his claim, but to no more.")

protection" is intended to insure for the secured creditor the benefit of its bargain.[6]

B. Timbers Has Been Interpreted By Some Lower Courts As Requiring Denial of Adequate Protection To The Equity Cushion.

Some courts read *Timbers* to deny adequate protection to the equity cushion. In the decision below, the court of appeals asked whether adequate protection "is designed only to protect against diminution in the value of the collateral," and answered in the affirmative. *In re Delta Resources, Inc.*, 54 F.3d 722, 728 (11th Cir. 1995); App. 12.[7] This approach seems rooted in

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[6] The Bankruptcy Code does not define "adequate protection." *In re Swedeland Dev. Group, Inc.*, 16 F.3d 552, 564 (3rd Cir. 1994) (en banc). Instead, it sets forth examples of "adequate protection" in § 361, which are not intended to be "exclusive or exhaustive." H.R. Rep. No. 595, 95th Cong., 1st Sess. 338-39 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6295. The House Report states as to § 361 in part:

> The section, and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. Secured creditors should not be deprived of the benefit of their bargain. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interest. Though the creditor might not receive his bargain in kind, the purpose of this section is to insure that the secured creditor receives in value essentially what he bargained for.

Id. at 339, 1978 U.S.C.C.A.N. at 6295.

[7] The court of appeals ruled: "[W]e hold the oversecured creditor's interest in property which must be adequately protected encompasses the decline in the value of the collateral only . . . ." 54 F.3d at 730; App. 17.

statements in *Timbers* that the interest to be protected is "the value of the collateral."[8] 484 U.S. at 372. In the oversecured context, however, the value of the collateral is greater than the value of the secured claim. A priming lien which eliminated the cushion (and hence the right to interest) could be imposed without a decline in collateral value. Preservation of collateral value does not protect the oversecured creditor's right to have the full amount of the security applied to the debt as matured, with interest, at plan confirmation (or upon distribution of collateral proceeds).

Other courts find that *Timbers* flatly denies any protection whatsoever to the equity cushion. For example, *In re Lane*, 108 B.R. 6, 10 (Bankr. D. Mass. 1989), takes that position, stressing that the Court in *Timbers* (citing 484 U.S. at 380) rejected the "benefit of the bargain" language in the legislative history of § 361 as a basis for postpetition interest.[9] Still other courts, relying on *Timbers*, express concern that protection of a small cushion through interest payments would allow the oversecured creditor to be paid more than § 506(b) of the Bankruptcy Code allows.[10]

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[8] The decision below states, "The Supreme Court has determined that '[t]he phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral.' . . . We think the phrase 'value of such entity's interest' in § 361(1) and (2), when applied to secured creditors, means the same.'" 54 F.3d at 728 (quoting *Timbers*, 484 U.S. at 372); App. 12.

[9] The Court's discussion in *Timbers* of legislative history (484 U.S. at 379-80) did not analyze the significance of such legislative statements in the context of oversecured claims.

[10] *See In re Westchase I Assocs., L.P.*, 126 B.R. 692, 694 (W.D.N.C. 1991) ("Certainly, had the Court or Congress intended that creditors who were only marginally oversecured receive interest payments to maintain their status, which might detrimentally affect undersecured

footnote continued on page 10

In sum, courts read *Timbers* to have conflicting meanings in the context of oversecured claims. The principles of *Timbers*, and how they apply to issues of interest payment and adequate protection of oversecured debt, need definition from the Court.

II. The Decision Below Threatens To Upset Accepted Practices As To Continuing Payment Of Interest On Oversecured Claims During Bankruptcy.

The vice of the decision below is not simply its reading of *Timbers*, but its categorical prohibition, as a matter of law, of interest payments as a form of adequate protection. The court of appeals flatly holds that the Bankruptcy Code "requires that the payment of accrued postpetition interest to an oversecured creditor await the completion of reorganization or confirmation of the bankruptcy case." 54 F.3d at 730; App. 16. Already, the

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creditors, they could have clearly expressed that intention."); *In re Senior Care Properties, Inc.*, 137 B.R. 527, 529 (Bankr. N.D. Fla. 1992) ("If periodic cash payments were permitted, it is conceivable that, over time, the secured creditor would be paid more than § 506(b) allows, unless, as one court suggests, the payments are taken from the creditor's cushion.") (citation omitted); *see also Lane*, 108 B.R. at 8 (noting that right to postpetition amounts under § 506(b) is subject to surcharge of collateral under § 506(c), which may be considerable and can accrue throughout case).

The answer to this concern is to recognize that "to the extent payments are made prior to plan confirmation, the cushion available to that secured creditor is accordingly reduced." *Senior Care*, 137 B.R. at 529; *accord In re McCombs Properties VI, Ltd.*, 88 B.R. 261, 266 (Bankr. C.D. Cal. 1988) ("[Section] 506(b) requires any payment of interest on a secured creditor's claim during the bankruptcy to be taken from the cushion."). This approach was taken in *In re Broomall Printing Corp.*, where the court refused to disburse the proceeds from a sale of collateral to an oversecured creditor to the extent the proceeds plus already paid postpetition principal and interest exceeded the value of the collateral. 131 B.R. 32, 135-36 (Bankr. D. Md. 1991).

holding below has caused a court to refuse approval of an adequate protection agreement providing for payment of postpetition interest. *In re M4 Enters., Inc.*, 183 B.R. 981, 986 (Bankr. N.D. Ga. 1995).

To understand the actual, practical effect of the decision below, it is best to focus on a typical situation where debt service might continue postpetition by stipulation or court order — a single-asset real estate case where the asset (an office building, shopping center, or apartment complex) generates sufficient rental income to service the debt and pay expenses. The property and the rents are liened to a single lender who is oversecured. The debtor may have filed for relief under chapter 11 because the debt has matured. Quite likely the property cannot be refinanced because (as recently experienced) the market is in upheaval, and the property cannot be sold for the value its income stream warrants without a lengthy exposure to an improving market.

The rents collected, and to be collected, by the hypothetical debtor constitute cash collateral under § 363(a) of the Bankruptcy Code. The debtor may not use the rents for any purpose unless it first obtains the lender's consent or obtains a court order upon proof of adequate protection, as provided in § 363(c) and § 363(e) of the Bankruptcy Code. Because cash (as opposed to any other) collateral is involved, no request from the lender is needed to trigger its adequate protection rights. 11 U.S.C. § 363(c)(2).

In this circumstance, typically, the mortgage lender and the debtor will attempt to negotiate a cash collateral stipulation, whereby interest will continue to be paid and a budget for expenses will be agreed upon. Possible charges against the collateral under § 506(c) of the Bankruptcy Code, such as real estate taxes, typically are reserved for in the budget.

Such cash collateral agreements are salutary. They avoid litigation at the outset of the case over the value of the asset and protection of the property and the rent it generates. In theory, the lender's interest in the net rents could also be protected by depositing them into a special escrow, with the funds left to sit and accumulate for the duration of the case. That is apparently what the court of appeals, in the decision below, believes to be required by the Bankruptcy Code and the Court's decision in *Timbers*, assuming the court of appeals would protect the lender's interest in postpetition rents.

But the fact is that interim interest payments are an accepted form of adequate protection for oversecured creditors. Such payments protect the oversecured lender's right to have the security cushion applied in payment of the debt, simply by using accumulated cash collateral to pay accrued interest. The leading treatise expressly notes payment of interest as a form of adequate protection where rents are involved. 2 *Collier on Bankruptcy* ¶ 361.01, at 361-7 (Lawrence P. King et al. eds., 15th ed. 1995).[11] While adequate protection orders are generally unreported, and often entered by stipulation, numerous reported decisions acknowledge or uphold payment of accrued postpetition interest to oversecured creditors prior to confirmation of a plan. *See, e.g., In re Revco D.S., Inc.*, 901 F.2d 1359, 1364-65 (6th Cir. 1990); *In re Veeco Inv. Co., L.P.*, 170 B.R. 149, 153 (Bankr. E.D. Mo. 1994); *In re Bloomingdale Partners*, 160 B.R. 93, 99-100 (Bankr. N.D. Ill. 1993); *see also* note 5, *supra* (citing cases).

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[11] Even commentators who urge that the equity cushion is not entitled to protection recognize that stipulations to pay postpetition interest are an accepted and salutary practice. "There are many situations in which payments to a creditor as part of an adequate protection arrangement might be described by the parties as interest, rather than as direct compensation for reduced property value." 3 *Chapter 11 Theory and Practice: A Guide to Reorganization* § 16.12 (James F. Queenan, Jr. et al. eds., 1994).

The decision below, relying on *Timbers*, reaches a categorical conclusion which threatens to upset accepted bankruptcy practice as to adequate protection payments to oversecured creditors and to hurt the lending community and the bankruptcy process itself. *Timbers* did not rule on payment of interest as adequate protection of oversecured debt. It set forth broad principles, from which courts dealing with such debt draw fundamentally different conclusions. *Timbers* is in need of authoritative clarification by the Court.

CONCLUSION

For the reasons stated herein and in the Petition for a Writ of Certiorari, American Council of Life Insurance, as *amicus*, respectfully submits that the Petition for a Writ of Certiorari should be granted.

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October 5, 1995

VIA FEDERAL EXPRESS

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Re: Orix Credit Alliance, Inc. v. Delta Resources, Inc.

Dear Mr. Epstein:

On Thursday, October 5, 1995 we spoke by telephone, and you advised that Petitioner Orix Credit Alliance, Inc. consents to the filing of an amicus curiae brief by the American Council of Life Insurance in connection with the petition for writ of certiorari in the above-referenced case. Pursuant to the Supreme Court Rule 37, I request that you sign, on the line provided below, to confirm in writing to your consent of the filing of this amicus brief. After you have done so, please return this document to me.

Very truly yours,

Robert B. Millner
Counsel for American Council of Life Insurance

RBM/jll/1193694

CONSENT TO FILING OF AMICUS BRIEF:

By: _____
David G. Epstein, Esq.
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Orix Credit Alliance, Inc.